

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Duvall Analyst: Victoria Favorito Bill Number: AB 2556
Related Bills: See Legislative History Telephone: 845-3825 Amended Date: April 3, 2008
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Health Insurance Premiums Deduction

SUMMARY

This bill would allow a deduction to taxpayers for health insurance premiums.

SUMMARY OF AMENDMENTS

The April 3, 2008, amendments would allow personal income taxpayers an additional deduction for health insurance premiums.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to allow personal income taxpayers to take a deduction for the cost paid for health insurance premiums.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws allow an itemized deduction for premiums paid for medical care insurance (hospital, surgical, and medical expense reimbursement coverage) and are deductible as a medical expense to the extent that, when added to all other unreimbursed medical expenses, the total exceeds 7.5% of the taxpayer's adjusted gross income¹ (AGI).

¹ Adjusted Gross Income (AGI) includes all gross income reduced by "above-the-line" deductions. Above-the-line deductions include certain trade or business deductions, contributions to an MSA, alimony paid, and contributions to pension and annuity plans.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Selvi Stanislaus

4/25/08

Under federal law, self-employed individuals are allowed to make an “above-the-line” deduction for health insurance premiums paid for medical expenses incurred by the taxpayer, taxpayer’s spouse, or the taxpayer’s and/or spouse’s dependents. The federal deduction is allowed in lieu of itemized deduction for medical expenses. State law allows this deduction in calculating California AGI.

THIS BILL

This bill would allow an “above the line” deduction equal to the cost paid or incurred during the taxable year for health insurance premiums for the taxpayer, taxpayer’s spouse, or the taxpayer’s and/or spouse’s dependents.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

The bill contains an undefined term, “health insurance premiums.” Insurance policies may cover both medical and nonmedical expenses; the bill does not specify whether the deduction is only related to medical expenses. Lack of definitions could cause disputes between taxpayers and the department. .

The bill is unclear whether the deduction is allowed for reimbursed premiums (whether by employer, separation agreement, etc.) or if premiums were paid pre-tax (through payroll deduction, HSA, etc.).

LEGISLATIVE HISTORY

AB 1040 (Duvall, 2007/2008) was nearly identical to this bill except that deductions were allowed for medical care expenses not compensated by insurance during the taxable year. AB 1040 failed to pass out of the first house by January 31 of the second year of the session.

AB 2200 (Pacheco, 1999/2000) would have allowed a deduction for medical expenses in excess of \$1,000 for taxpayers who are 65 years or older. AB 2200 failed to pass out of Assembly Appropriations Committee.

AB 2267 (Baugh, 1997/1998) would have allowed taxpayer’s to deduct 100% of their medical expenses without regard to whether the expenses exceed 7.5% of AGI. AB 2267 failed to be heard in a policy committee in the first house.

AB 2330 (Poochigian, 1997/1998) would have reduced the percentage of medical expenses that may be deducted from those exceeding 7.5% of AGI to those exceeding 2% of AGI over a 5-year period. AB 2330 was held in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have personal income tax. *Illinois, Massachusetts, Michigan, Minnesota, and New York* do not allow a deduction that is similar to this bill, but like California conform to the federal itemized deduction allowed for medical expenses, if the expenses exceed 7.5% of a taxpayer's AGI.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 2556 Enactment Assumed After June 30, 2008 (\$ in Billions)			
	2008-9	2009-10	2010-11
Revenue Impact	-\$1.5	-\$1.3	-\$1.4

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Using national and state level data, the amount of health insurance premiums paid by California taxpayers for 2008 are projected to be approximately \$20 billion. This estimate assumes that contributions to health insurance by employees who have Internal Revenue Code section 125, cafeteria plans, are not deductible under this proposal. Estimates assume that taxpayers can also itemize the same health insurance premium costs. Applying a tax rate of 6%, the tax revenue impact of the proposal for 2008 is approximately \$1.2 billion (\$20 billion × 6%).

The numbers in the table above have been adjusted to reflect revenue estimates for fiscal years.

POLICY CONSIDERATIONS

This bill would create differences between federal and California law, thereby increasing the complexity of California tax return preparation. California law would allow an "above-the-line" deduction for medical expenses, while federal law would continue to treat costs for medical care (with the exception of the medical expense deduction for self-employed individuals), as a "below-the-line" deduction subject to an AGI limitation.

This bill would allow an “above-the-line” deduction equal to the cost paid for health insurance premiums. Current state law already allows an itemized deduction for health insurance premiums. Thus, this bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

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